COPY

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1960

No. 151

JOHN T. JARECKI, FORMER COLLECTOR OF INTERNAL REVENUE, ET AL., PETITIONERS,

vs.

G. D. SEARLE & CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 16, 1960
CERTIORARI GRANTED OCTOBER 10, 1960

Supreme Court of the United States

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[fol. 1]

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

APPENDIX FOR PLAINTIFF-APPELLANT

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No. 57-C-1717

G. D. SEARLE & Co., a corporation, PLAINTIFF,

vs.

JOHN T. JARECKI, former Collector of Internal Revenue, and ERNEST J. SAUBER, former Collector of Internal Revenue and former District Director in Internal Revenue, DEFENDANTS

PREFIX TO RECORD

This action was brought by G. D. Searle & Co. on complaint filed October 16, 1957, in the United States District Court for the Northern District of Illinois, Eastern Division. Defendants John T. Jarecki and Ernest J. Sauber answered on December 16, 1957. Defendants filed two sets of interrogatories on May 29 and June 11, 1958, which were answered by plaintiff on June 13 and July 11, respectively. A stipulation of facts was filed on February 16, 1959. On plaintiff's motion, the court ordered separate trial of certain issues on February 19, 1959. Requests for admissions under Rule 36 were filed by both parties; defendants' on March 19 and plaintiff's on March 23, 1959. Answers to these requests were filed on March 30 by plaintiff, and by defendants on April 2 after their objec-
[fol. 2] tions were overruled following oral argument on March 31. On March 31 defendants also presented a motion for summary judgment. Briefs were filed by both parties and argument heard on April 28. On May 11,

Judge Igoe entered findings of fact, conclusions of law and summary judgment for defendants. Plaintiff filed notice of appeal on July 10, 1959.

Pleas had at a regular term of the United States District Court for the Eastern Division of the Northern District of Illinois begun and held in the United States Court Rooms in the City of Chicago in the Division and District aforesaid on the first Monday of May, being the 4th day thereof, in the Year of Our Lord One Thousand Nine Hundred Fifty-Nine and of the Independence of the United States of America, the 183rd Year.

Present:

Honorable Gunnar H. Nordbye, District Judge.
Honorable William J. Campbell, Chief District Judge.
Honorable Philip L. Sullivan, District Judge.
Honorable Michael L. Igoe, District Judge.
Honorable Walter J. La Buy, District Judge.
Honorable J. Sam Perry, District Judge.
Honorable Julius J. Hoffman, District Judge.
Honorable Julius H. Miner, District Judge.
Honorable Edwin A. Robson, District Judge.
Roy H. Johnson, Clerk.
William W. Kipp, Sr., Marshal.

Monday, May 11, 1959.

Court Met Pursuant to Adjournment.

Present: Honorable Michael L. Igoe, Trial Judge.

[fol. 3] IN THE
UNITED STATES DISTRICT COURT

* * * *

COMPLAINT—Filed October 16, 1957

Plaintiff, G. D. Searle & Co., a Delaware corporation, for its complaint alleges as follows:

COUNT I.

1. This action is brought pursuant to the provisions of the Act of June 25, 1948, c. 646, 62 Stat. 932, U. S. C. Title 28, § 1340, to recover an internal revenue tax, to wit, excess profits tax, erroneously and illegally assessed. Plaintiff is a corporation duly organized and existing under the laws of the State of Delaware and has its principal office at Searle Parkway, Skokie, Illinois.

2. During all times material to this proceeding plaintiff was engaged in, and derived its income from, the sale of ethical drugs manufactured by plaintiff.

3. As a result of plaintiff's activities extending over a period of more than twelve months, to wit, the calendar years 1946 to 1949, inclusive, plaintiff discovered two compositions of matter, the ethical drugs respectively called Banthine and Dramamine, and new and valuable clinical applications therefor.

4. The only products which plaintiff discovered, and from which discoveries plaintiff derived income during any time material to this proceeding, are Banthine and Dramamine.

5. During the calendar year 1950 plaintiff derived income of a class described in Section 456 of the Internal Revenue Code of 1939 from its discovery of Banthine and Dramamine. Such income constituted a class of income [fol. 4] which is reasonable in a business of the type which plaintiff conducts and is appropriate in the light of plaintiff's business experience and accounting practice.

6. On or before March 15, 1951 plaintiff filed its tentative corporate income and excess profits tax returns for the calendar year 1950, and on or before June 13, 1951

plaintiff filed its final corporate income tax return for the calendar year 1950, with defendant John T. Jarecki, then Collector of Internal Revenue for the First Collection District of Illinois, in which plaintiff erroneously reported excess profits tax liability in the total amount of $558,339.11. Plaintiff erroneously paid this amount to John T. Jarecki, then Collector as aforesaid, in installments as follows:

Date	Amount
March 15, 1951	$169,020.42
June 13, 1951	165,983.05
September 14, 1951	111,667.82
December 14, 1951	111,667.82

Thereafter, on or about December 12, 1952, plaintiff erroneously paid to defendant Ernest J. Sauber, then District Director of Internal Revenue at Chicago, Illinois, additional excess profits tax erroneously and illegally assessed for the calendar year 1950 in the amount of $1,537.32.

7. During the calendar year 1950 plaintiff realized and included in its gross income for such year net abnormal income attributable to previous years, to wit, the calendar years 1940 to 1949, inclusive, resulting from discovery of Banthine and Dramamine, and erroneously included in its income tax return for 1950 the net abnormal income attributable to such previous years and erroneously paid the tax shown due by reason of such erroneous inclusion. [fol. 5] 8. Plaintiff's net abnormal income for the calendar year 1950 and the excess profits tax which plaintiff erroneously paid with respect thereto are determined and computed as follows:

(a) Plaintiff's net abnormal income.

(i) Plaintiff's abnormal income consisting of gross profit (net sales less cost of sales) from sales of Banthine and Dramamine $4,977,986

Plaintiff's gross profits from sales of such drugs for preceding four calendar years:		
1946	$ 0	
1947	0	
1948	0	
1949	809,458	
Total	$ 809,458	
Plaintiff's average gross profit for such years	$ 202,364	
(ii) Reduction of 115% of such average gross profit		$ 232,719
		$4,745,267

[fol. 6] (iii) Reduction for expenses attributable to abnormal income, determined as follows:

Amount of costs and deductions for the calendar year 1950 relating to plaintiff's net abnormal income for calendar year 1950 allowable in determining plaintiff's normal tax net income for calendar year 1950	$1,638,010	
Ratio (percentage) which plaintiff's abnormal income for calendar year 1950, reduced as provided in subparagraph (ii) above ($4,745,267), bears to plaintiff's net abnormal income for calendar year 1950 ($4,977,986)	95.33%	
95.33% of such costs and deductions for calendar year 1950		1,561,515
(iv) Plaintiff's net abnormal income for calendar year 1950		3,183,752
Amount of plaintiff's net abnormal income allocated to:		
Item Banthine	$1,964,768	
Item Dramamine	1,218,894	
Total	$3,183,752	

(b) Excess profits tax erroneously paid by plaintiff.

Plaintiff's adjusted excess profits tax net income for calendar year 1950	$3,702,081.00
Less exclusion of net abnormal income	3,183,752.00
Adjusted excess profits net income without inclusion of net abnormal income	518,329.00
Excess profits tax at 30%	155,498.70
Total excess profits tax paid by plaintiff for calendar year 1950	559,876.43
184/365ths of $155,498.70	78,388.39
Excess profits tax erroneously paid by plaintiff for calendar year 1950	$ 481,488.04

[fol. 7] 9. On or about March 10, 1954 plaintiff duly filed with defendant Ernest J. Sauber, District Director of Internal Revenue as aforesaid, claim for refund of excess profits tax for the calendar year 1950 based upon the inclusion in plaintiff's excess profits net income for the calendar year 1950 of net abnormal income derived from Banthine and Dramamine as aforesaid. The grounds for allowance of such claim for refund were set out in the claim in substantially the form herein set forth.

10. On October 27, 1955 the Secretary of the Treasury mailed to plaintiff, by registered mail, a notice of the disallowance of plaintiff's claim for refund of excess profits tax for the calendar year 1950.

11. Plaintiff erroneously made payments in respect of its excess profits tax liability for the calendar year 1950 in the amount of $481,488.04. Plaintiff is entitled to a refund under the provisions of Section 6511 of the Internal Revenue Code of 1954 in the sum of $481,488.04 or such greater amount as this Court may determine, together with interest thereon at the rate of 6% per annum from the respective dates of payment, as aforesaid, until paid to plaintiff.

Wherefore plaintiff prays judgment against defendants in the sum of $481,488.04, or such other greater amount as this Court may determine, together with interest thereon at the rate of 6% per annum from the respective dates

of payment, as aforesaid, until paid to plaintiff, and for any other, further and different relief to which this Court may find plaintiff entitled.

In the alternative plaintiff prays judgment against defendant Ernest J. Sauber in the amount of $1,537.32, together with interest thereon at the rate of 6% per annum from December 12, 1952 until paid to plaintiff; and against defendant John T. Parecki in the amount of [fol. 8] $481,488.04, or such other greater amount as this Court may determine, together with interest thereon at the rate of 6% per annum from the respective dates of payment as aforesaid until paid to plaintiff; and for any other further and different relief to which this Court may find plaintiff entitled.

COUNT II.

1-4, inclusive. Plaintiff hereby adopts, by reference, paragraphs 1 to 4, inclusive, of Count I hereof as paragraphs 1 to 4, inclusive, of Count II.

5. During the calendar year 1951 plaintiff derived income of a class described in Section 456 of the Internal Revenue Code of 1939 from its discovery of Banthine and Dramamine. Such income constituted a class of income which is reasonable in a business of the type which plaintiff conducts and is appropriate in the light of plaintiff's business experience and accounting practice.

6. On or before March 13, 1952 plaintiff filed with defendant John T. Jarecki, then Collector of Internal Revenue for the First Collection District of Illinois, its corporate income and excess profits tax returns for the calendar year 1951 in which it erroneously reported excess profits tax liability in the total amount of $2,047,010.81. Plaintiff erroneously paid this amount to John T. Jarecki, then Collector as aforesaid, in installments as follows:

Date	Amount
March 13, 1952	$716,453.79
June 13, 1952	716,453.78
September 12, 1952	307,051.62
December 12, 1952	307,051.62

7. During the calendar year 1951 plaintiff realized and included in its gross income for such year net [fol. 9] abnormal income attributable to previous years, to wit, the calendar years 1946 to 1949, inclusive, resulting from discovery of Banthine and Dramamine, and erroneously included in its income tax return for 1951 the net abnormal income attributable to such previous years and erroneously paid the tax shown due by reason of such erroneous inclusion.

8. Plaintiff's net abnormal income for the calendar year 1951 and the excess profits tax which plaintiff erroneously paid with respect thereto are determined and computed as follows:

(a) Plaintiff's net abnormal income.

(i) Plaintiff's abnormal income consisting of gross profit (net sales less cost of sales) from sales of Banthine and Dramamine		$10,760,993
Plaintiff's gross profits from sales of such drugs for preceding four calendar years:		
1947	$ 0	
1948	0	
1948	809,458	
1950	4,977,986	
Total	$5,787,444	
Plaintiff's average gross profit for such years	$1,446,861	
(ii) Reduction of 115% of such average gross profits		$1,663,890
		$9,106,103

[fol. 10] (iii) Reduction for expenses attributable to abnormal income, determined as follows:

Amount of costs and deductions for the calendar year 1951 relating to plaintiff's net abnormal income for calendar 1951 allowable in determining plaintiff's normal tax net income for calendar year 1951	$2,642,807	
Ratio (percentage) which plaintiff's abnormal income for calendar year 1951, reduced as provided in subparagraph (ii) above ($9,106,103), bears to plaintiff's net abnormal income for calendar year 1951 ($10,769,993)	84.55%	
84.55% of such costs and deductions for calendar year 1951		$2,234,493
(iv) Plaintiff's net abnormal income for calendar year 1951		6,871,610
Amount of plaintiff's net abnormal income allocated to:		
Item Banthine	$5,602,275	
Item Dramamine	1,269,335	
Total	$6,871,610	

[fol. 11] (b) Excess profits tax erroneously paid by plaintiff.

Plaintiff's adjusted excess profits tax net income for calendar year 1951	$7,015,456
Less exclusion of net abnormal income	6,871,610
Adjusted excess profits net income without exclusion of net abnormal income	143,846
Excess profits tax at 30%	43,153.80
Total excess profits tax paid by plaintiff for calendar year 1951	2,047,010.81
Correct excess profits tax	43,153.80
Excess profits tax erroneously paid by plaintiff for calendar year 1951	$2,003,857.01

9. On or about March 10, 1955 plaintiff duly filed with defendant Ernest J. Sauber, District Director of Internal Revenue as aforesaid, claim for refund of excess profits tax for the calendar year 1951 based upon the inclusion in plaintiff's excess profits net income for the calendar year 1951 of net abnormal income derived from Banthine and Dramamine as aforesaid. The grounds for allowance of such claim for refund were set out in the claim in substantially the form herein set forth.

10. On October 27, 1955 the Secretary of the Treasury mailed to plaintiff, by registered mail, a notice of the disallowance of plaintiff's claim for refund of excess profits tax for the calendar year 1951.

11. Plaintiff erroneously made payments in respect of its excess profits tax liability for the calendar year 1951 in the amount of $2,003,857.01. Plaintiff is entitled to a [fol. 12] refund under the provisions of Section 6511 of the Internal Revenue Code of 1954 in the sum of $2,003,857.01 or such greater amount as this Court may determine, together with interest thereon at the rate of 6% per annum from the respective dates of payment, as aforesaid, until paid to plaintiff.

Whereof plaintiff prays judgment against defendants in the sum of $2,003,857.01, or such other greater amount

as this Court may determine, together with interest thereon at the rate of 6% per annum from the respective dates of payment, as aforesaid, until paid to plaintiff, and for any other, further and different relief to which this Court may find plaintiff entitled.

In the alternative plaintiff prays judgment against defendant John T. Jarecki in the amount of $716,453.79, together with interest thereon at the rate of 6% per annum from March 15, 1952 until paid to plaintiff; and against defendant Ernest J. Sauber in the amount of $2,003,857.01, or such other greater amount as this Court may determine, together with interest thereon at the rate of 6% per annum from the respective dates of payment as aforesaid until paid to plaintiff; and for any other further and different relief to which this Court may find plaintiff entitled.

COUNT III.

1-4 inclusive. Plaintiff hereby adopts, by reference, paragraphs 1 to 4 inclusive, of Count I hereof as paragraphs 1 to 4, inclusive, of Count III.

5. During the calendar year 1952 plaintiff derived income of a class described in Section 456 of the Internal Revenue Code of 1939 from its discovery of Banthine and Dramamine. Such income constituted a class of income which is reasonable in a business of the type which plain-
[fol. 13] tiff conducts and is appropriate in the light of plaintiff's business experience and accounting practice.

6. On or before March 13, 1953 plaintiff filed with defendant Ernest J. Sauber, then District Director of Internal Revenue at Chicago, Illinois, its corporate income and excess profits tax returns for the calendar year 1952 in which it erroneously reported excess profits tax liability in the total amount of $1,634,421.14. Plaintiff erroneously paid this amount to Ernest J. Sauber, then District Director as aforesaid, in installments as follows:

Date	Amount
March 13, 1953	$653,768.46
June 15, 1953	653,768.46
September 15, 1953	163,442.11
December 15, 1953	163,442.11

Thereafter, on or about September 29, 1955, plaintiff erroneously paid to defendant Ernest J. Sauber, then District Director as aforesaid, additional excess profits tax erroneously and illegally assessed for the calendar year 1952 in the amount of $12,492.63.

7. During the calendar year 1952 plaintiff realized and included in its gross income for such year net abnormal income attributable to previous years, to wit, the calendar years 1946 to 1949, inclusive, resulting from discovery of Banthine and Dramamine, and erroneously included in its income tax return for 1952 the net abnormal income attributable to such previous years and erroneously paid the tax shown due by reason of such erroneous inclusion.

8. Plaintiff's net abnormal income for the calendar year 1952 and the excess profits tax which plaintiff erroneously paid with respect thereto are determined and computed as follows:

[fol. 14] (a) Plaintiff's net abnormal income.

(i) Plaintiff's abnormal income consisting of gross profit (net sales less cost of sales) from sales of Banthine and Dramamine		$9,796,150
Plaintiff's gross profits from sales of such drugs for preceding four calendar years:		
1948	$ 0	
1949	809,458	
1950	4,977,986	
1951	10,769,993	
Total	$16,557,437	
Plaintiff's average gross profit for such years	$ 4,139,359	
(ii) Reduction of 115% of such average gross profit		$4,760,263
		$5,035,887

[fol. 15] (iii) Reduction for expenses attributable to abnormal income, determined as follows:

Amount of costs and deductions for the calendar year 1952 relating to plaintiff's net abnormal income for calendar year 1952 allowable in determining plaintiff's normal tax net income for calendar year 1952	$ 2,900,505	
Ratio (percentage) which plaintiff's abnormal income for calendar year 1952, reduced as provided in subparagraph (ii) above ($5,035,887), bears to plaintiff's net abnormal income for calendar year 1952 ($9,796,150)	51.41%	
51.41% of such costs and deductions for calendar year 1952		1,491,150
(iv) Plaintiff's net abnormal income for calendar year 1952		3,544,737
Amount of plaintiff's net abnormal income allocated to:		
Item Banthine	$ 2,579,658	
Item Dramamine	965,079	
Total	$ 3,544,737	

[fol. 16] (b) Excess profits tax erroneously paid by plaintiff.

Plaintiff's adjusted excess profits tax net income for calendar year 1952	$5,191,472
Less exclusion of net abnormal income	3,544,737
Adjusted excess profits net income without inclusion of net abnormal income	1,646,735
Excess profits tax at 30%	494,020
Total excess profits tax paid by plaintiff for calendar year 1952	1,646,913.77
Correct excess profits tax	494,020
Excess profits tax erroneously paid by plaintiff for calendar year 1952	$1,152,893.77

9. On or about March 5, 1956 plaintiff duly filed with defendant Ernest J. Sauber, District Director of Internal Revenue as aforesaid, claims for refund of excess profits tax for the calendar year 1952 based upon the inclusion in plaintiff's excess profits net income for the calendar year 1952 of net abnormal income derived from Banthine and Dramamine as aforesaid. The grounds for allowance of such claim for refund were set out in the claim in substantially the form herein set forth.

10. On February 14, 1957 the Secretary of the Treasury mailed to plaintiff, by registered mail, a notice of the disallowance of plaintiff's claim for refund of excess profits tax for the calendar year 1952.

11. Plaintiff erroneously made payments in respect of its excess profits tax liability for the calendar year 1952 in the amount of $1,152,893.77. Plaintiff is entitled to a refund under the provisions of Section 6511 of the Internal Revenue Code of 1954 in the sum of $1,152,893.77 or such greater amount as this Court may determine, together with interest thereon at the rate of 6% per

[fol. 17] annum from the respective dates of payment, as aforesaid, until paid to plaintiff.

Wherefore plaintiff prays judgment against defendant Ernest J. Sauber in the sum of $1,152,893.77, or such other greater amount as this Court may determine, together with interest thereon at the rate of 6% per annum from the respective dates of payment, as aforesaid, until paid to plaintiff, and for any other, further and different relief to which this Court may find plaintiff entitled.

Edwin C. Austin,
Middleton Miller,
Howard P. Robinson,
11 South LaSalle Street,
Chicago 3, Illinois,
Attorneys for Plaintiff.

Sidley, Austin, Burgess & Smith,
11 South LaSalle Street,
Chicago 3, Illinois,
Of Counsel.

[fol. 18] IN THE
UNITED STATES DISTRICT COURT

* * * *

ANSWER—Filed December 16, 1957

Come now the defendants and answer the plaintiff's complaint as follows:

COUNT I.

1. Admits the allegations of paragraph 1, except defendants deny that any taxes were erroneously or illegally assessed or collected from the plaintiff.

2. Defendants admit that plaintiff manufactures and sells ethical drugs, but are without knowledge or information sufficient to form a belief as to whether plaintiff derives all its income from the manufacture and sale of ethical drugs.

3. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 3.

4. Defendants are without knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph 4.

5. Deny the allegations of paragraph 5.

6. Deny the allegations of paragraph 6, except defendants admit that plaintiff filed its corporate income and excess profits tax returns for the calendar year 1950 on or about the dates alleged and reported excess profits tax liability in the amount stated. Defendants deny that plaintiff paid any amount of taxes erroneously and allege that income and excess profits taxes for the taxable year [fol. 19] 1950 were paid by the plaintiff to the defendants in the following amounts and on the following dates:

March 15, 1951	$1,200,000.00
June 20, 1951	1,178,439.14
October 2, 1951	792,813.04
December 16, 1951	10,479.22
January 5, 1952	792,813.04

7. Deny the allegations of paragraph 7.

8. Deny the allegations of paragraph 8.

9. Defendants admit that plaintiff filed a claim for refund on or about March 10, 1954, but deny each and every allegation in said claim or in support thereof not specifically admitted elsewhere herein.

10. Admit the allegations of paragraph 10.

11. Deny the allegations of paragraph 11.

COUNT II.

1-4, inclusive. Defendants adopt by reference paragraphs 1 to 4, inclusive, of their answers of Count I hereof as paragraphs 1 to 4, inclusive of Count II.

5. Deny the allegations of paragraph 5.

6. Deny the allegations of paragraph 6, except defendants admit that plaintiff filed its corporate income and excess profits tax returns for the calendar year 1951 on March 14, 1952 and reported excess profits tax liability in the amount of $2,047,010.81, and that plaintiff paid to the defendant the following amounts on the following dates:

March 14, 1952	$2,822,350.29
August 18, 1952	2,822,350.29
December 16, 1952	1,209,578.69
December 19, 1952	1,209,578.68

7. Deny the allegations of paragraph 7.

8. Deny the allegations of paragraph 8.

9. Defendants admit that plaintiff filed a claim for refund, but deny each and every allegation in said claim [fol. 20] or in support thereof not specifically admitted elsewhere herein.

10. Admit the allegations of paragraph 10.

11. Deny the allegations of paragraph 11.

COUNT III.

1-4, inclusive. Defendants adopt by reference paragraphs 1 to 4, inclusive, of their answers of Count I hereof as paragraphs 1 to 4, inclusive, of Count III.

5. Deny the allegations of paragraph 5.

6. Deny the allegations of paragraph 6, except defendants admit that plaintiff filed its corporate income and

excess profits tax returns for the calendar year 1952 on March 16, 1953 and paid the following amounts on the following dates:

March 16, 1953	$2,806,485.54
June 29, 1953	2,806,485.54
September 25, 1953	701,621.39
December 17, 1953	701,621.38
October 4, 1955	38,614.23

7. Deny the allegations of paragraph 7.
8. Deny the allegations of paragraph 8.
9. Admit that plaintiff filed a claim for refund, but deny each and every allegation in said claim or in support thereof not specifically admitted elsewhere herein.
10. Admit the allegations of paragraph 10.
11. Deny the allegations of paragraph 11.

Wherefore, having fully answered, the defendants pray for dismissal of the plaintiff's complaint, for judgment in their favor, for the costs of this action, and for all other relief which to the Court may seem just and proper.

R. Tieken,
United States Attorney.

[fol. 21] IN THE
UNITED STATES DISTRICT COURT

• • • • •

DEFENDANT'S INTERROGATORIES TO PLAINTIFF—Filed May 29, 1958

Pursuant to Rule 33, Federal Rules of Civil Procedure, defendants request plaintiff to answer the following interrogatories separately and fully in writing and under oath, and to serve a copy upon undersigned counsel for defendants within fifteen days after service hereof:

1. Name the patented drugs for which plaintiff has applied for and been granted a patent on the chemical formula by the United States Patent Office.

2. List the dates that the patents described in Interrogatory 1, above, were issued by the United States Patent Office.

3. State the income received from the sale of plaintiff's own patented drugs described in Interrogatory 1, above, from 1940 through 1953, inclusive.

R. Tieken,
United States Attorney.

Proof of service
(omitted in printing)

[fol. 22] IN THE
UNITED STATES DISTRICT COURT

• • • •

DEFENDANT'S INTERROGATORIES TO PLAINTIFF—Filed June 11, 1958

Pursuant to Rule 33, Federal Rules of Civil Procedure, defendants request plaintiff to answer the following interrogatories separately and fully in writing and under oath, and to serve a copy upon undersigned counsel for defendants within fifteen days after service hereof:

1. State the research facilities devoted by plaintiff to the research and development of ethical drugs from 1940-1953, inclusive.

2. State the research staff devoted by plaintiff to the research and development of ethical drugs from 1940-1953, inclusive.

3. State the research expenses devoted by plaintiff to the research and development of ethical drugs from 1940-1953, inclusive.

R. Tieken,
United States Attorney.

Proof of service
(omitted in printing)

[fol. 23] IN THE
UNITED STATES DISTRICT COURT

* * * *

PLAINTIFF'S ANSWER TO DEFENDANTS' INTERROGATORIES

On May 29, 1958, the defendants served three interrogatories upon the plaintiff. Plaintiff answers those interrogatories as follows:

1. From 1940 through 1953, plaintiff applied for and was granted patents on the chemical formulas of the following drugs* that it marketed:

Pavatrine Dramamine Banthine

2. The dates that the foregoing patents were issued by the United States Patent Office are as follows:

Pavatrine	November 18, 1941
Dramamine	February 28, 1950
Banthine	November 17, 1953

3. During said period, plaintiff received the following income (gross sales) from those drugs:

	1940	1941	1942	1943	1944	1945	1946
Pavatrine			$512	$ 167,326	$ 378,936	$ 618,320	$ 770,826
Dramamine							
Banthine							

	1947	1948	1949	1950	1951	1952	1953
Pavatrine	$894,562	$945,314	$1,064,072	$1,005,178	$ 844,939	$ 776,174	$ 682,911
Dramamine			$ 908,398	$2,044,797	$2,484,406	$3,324,933	$3,629,280
Banthine				$3,328,606	$9,347,180	$8,348,212	$8,506,288*

* Includes Pro-Banthine.

K. D. Bowes, *Treasurer, G. D. Searle & Co.*

Subscribed and sworn to before me this 12th day of June, 1958.
(Seal) Dorothy M. Purck, *Notary Public.*

* We have not included in the classification of drugs an antiseptic that plaintiff sold in negligible quantities from 1941 to 1945.

[fol. 24] IN THE
UNITED STATES DISTRICT COURT

* * * *

PLAINTIFF'S ANSWERS TO DEFENDANTS' INTERROGATORIES OF JUNE 11, 1958

Plaintiff considers the Government's second set of interrogatories, served on June 11, 1958, to be irrelevant to the issues herein and therefore objectionable. However, to save the time of the Court and to avoid delaying the disposition of this cause, but without waiving any objections as to relevancy, plaintiff answers those interrogations as follows:

1. From 1940 until March 1942, Searle's research facilities consisted of laboratories in the Company's quarters at Ravenswood and Lawrence Avenues in Chicago, Illinois. In March 1942, Searle occupied its Building A in Skokie, Illinois, consisting of 107,400 square feet, of which 12,400 square feet were occupied by Searle's research facilities. In 1947, an additional 11,600 square feet were added in research facilities, and 2,700 square feet were simultaneously released in Building A. Thus in 1947, Searle's research facilities occupied 21,300 square feet. In 1948, 17,100 square feet were added, and in 1950 an additional 12,400 square feet were added, making a total of 50,800 square feet, in contrast to Searle's non-research facilities space of 204,100 square feet.[1]

[fol. 25] 2. The following chart depicts Searle's research staff from 1943 through 1953 (the figures are unavailable for 1940 through 1942):

[1] The figures in paragraph 1 are of course approximations.

G. D. SEARLE & CO.

Research Personnel

Research	1943	1944	1945	1946	1947	1948	1949	1950	1951	1952	1953
Analytical & Control [2]					17	21	23	27	27	29	25
Biology Labs.					18	21	24	37	40	50	56
Chemical Research					16	19	23	24	37	48	50
Clinical					2	2	2	3	4	4	5
Research office, Library, Patents					6	6	5	6	8	9	7
Biology office									5	3	3
Chemical Research Office											3
Dishwashing, Stockroom						1	1	1	4	5	5
Animal Room					4	4	6	6	7	9	9
Research Engineering [3]						3	3	3	3	3	3
	23	26	32	47	63	77	87	107	135	160	166

3. Searle's research expenses for 1949 through 1953 are as follows (the figures are unavailable for 1940 through 1948):

1949	$887,660
1950	$1,166,486
1951	$1,613,272
1952	$2,130,190
1953	$1,861,266

K. D. Bowes,
Treasurer, G. D. Searle & Co.

Subscribed and sworn to before me this 7th day of July, 1958.

Gertrude C. Biesmann,
Notary Public.

(Seal)

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[2] Although persons in this group report to Searle's Vice President In Charge of Research, actually their work is largely non-research work.

[3] See note 2 above.

[fol. 26] IN THE
UNITED STATES DISTRICT COURT

* * * *

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto that for the purpose of this action the following facts are to be taken as true, subject to the right of either party to introduce such further evidence as is not inconsistent herewith:

1. Plaintiff is a Delaware corporation with its principal place of business in Skokie, Illinois. It brings this action to recover excess profits taxes which it alleges were erroneously and illegally assessed and collected by defendants for the calendar years 1950, 1951 and 1952.

2. Plaintiff manufactures and markets ethical drugs and derives income therefrom.

3. Prior to 1950, and over a period of more than twelve months, plaintiff incurred expenditures which resulted in the preparation and manufacture of two pharmaceuticals whose trade names are, respectively, Banthine and Dramamine.

4. During the years 1950, 1951 and 1952, plaintiff derived income from the sales of Banthine and Dramamine. It is this income which the plaintiff claims constituted abnormal income within the meaning of Section 456(a)(2) of the Internal Revenue Code of 1939. This claim, which is controverted by the defendants, is the sole basis of the complaint in this case.

[fol. 27] 5. Plaintiff applied for and received product patents on the following drugs that it marketed during the 1940-1953 period:

Product	Filed	Granted
Pavatrine	4-20-40	11-18-41
Dramamine	3-18-49	2-28-50
Banthine	5-10-52	11-17-53

its applications for such patents were denied on the following:

Product	Filed	Abandoned
Hydryllin	4-29-47	7-10-52
Tetrathione	8-7-42	4-30-48

Walter J. Cummings, Jr.,
Attorney for Plaintiff,

R. Tieken,
Attorney for Defendants.

IN THE UNITED STATES DISTRICT COURT

* * * * *

ORDER RE TRIAL ISSUES—Febuary 19, 1959

The Court, having considered the plaintiff's motion for separate trials of the issues herein pursuant to Rule 42(b) of the Federal Rules of Civil Procedure, and having heard arguments of counsel and being fully advised in the premises, hereby orders that the questions whether or not plaintiff's income from Banthine and Dramamine was income resulting from "discovery" constituting a class of income under the provisions of subparagraph (B) of Sec- [fol. 28] tion 458(a)(2) of the Internal Revenue Code of 1939 or was income of a class not described in subparagraphs (A) and (D), inclusive, of such section and subject to Regulations prescribed by the Secretary of the Treasury shall be tried in advance of the remaining issues herein, which shall be held in abeyance pending final decision of those questions, including any appellate review thereof.

The Government having no objection, it is further ordered that a trial by jury herein is waived.

Enter:
Igoe,
United States District Court Judge.

IN THE UNITED STATES DISTRICT COURT

• • • •

REQUEST FOR ADMISSIONS UNDER RULE 36—Filed March 19, 1959

The defendants, John T. Jarecki and Ernest J. Sauber, request the plaintiff, G. D. Searle & Co., a corporation, within ten (10) days after service of this request to make the following admissions for the purpose of this action only and subject to all pertinent objections to admissibility which may be made.

1. That Exhibit A, attached to this request, is an accurate photostat of a statement submitted by the plaintiff to the Internal Revenue Service during 1943.

2. That Exhibit B, attached to this request, is an accurate photostat of a prospectus issued by the plaintiff on February 7, 1950, covering the matters and issued for the purposes stated therein.

3. That Exhibit C, attached to this request is an accurate photostat of a statement submitted by the plaintiff to the Internal Revenue Service during 1943.

[fol. 29] 4. That Exhibit D, attached to this request, is an accurate photostat of the plaintiff's annual report for the year 1950, which report was distributed to its shareholders.

5. That Exhibit E, attached to this request, is an accurate photostat of the plaintiff's annual report for the year 1951, which report was distributed to its shareholders.

6. That each of the following statements is true:

(a) In a meeting dated January 16, 1950, the Board of Directors of the plaintiff voted to insert the following wording in Article Four of its Articles of Incorporation, which article deals with the purposes of the plaintiff's business.

> To engage in, carry on, or otherwise conduct, or employ others to conduct, general research or investigation for the development of new or improved products or by-products or uses for such

products or by-products, for improving the case or efficiency of the corporation or for other purposes.

(b) That, according to the laws of the state of plaintiff's incorporation, its Articles of Incorporation were amended as set out in the quoted portion of request (a).

(c) That on the army transport General Ballou, which left New York City on November 27, 1948, the drug Dramamine, referred to in paragraph 3 of the stipulation herein filed, was tested by the United States Army under actual rough weather conditions. This test was called "Operation Seasickness."

(d) Subsequent to the completion of the test referred to in request (c) and prior to 1950 the plaintiff published and mailed to prospective purchasers of the drug, Dramamine, a pamphlet entitled "Opera-
[fol. 30] tion Seasickness" and on page 14 of that pamphlet the following statements were made:

> Dramamine is a distinct chemical entity recently developed in the Research Laboratories of G. D. Searle & Co.
>
> • • • •
>
> The introduction of Dramamine and Hydryllin represent simply two recent illustrations of a research policy which dates back many years in the progress of G. D. Searle & Co.
>
> • • • •
>
> (If the plaintiff feels that this quote is misleading as out of context the defendants suggest that in its answer to this request the plaintiff add whatever other language it feels cures that problem.)

(e) The chemical drug compounds known as Dramamine and Banthine, referred to in paragraph 3 of the stipulation herein filed, were not in existence prior to their being prepared by man through experiments with various chemical formulas.

(The word "prepared" is to have the same meaning in this request as it has in paragraph 3 of the stipulation herein filed.)

R. Tieken,
United States Attorney, Attorney for the Defendants.

Proof of service
(omitted in printing)

[fol. 31] IN THE
UNITED STATES DISTRICT COURT

• • • •

REQUEST FOR ADMISSIONS UNDER RULE 36—Filed March 23, 1959

The plaintiff, G. D. Searle & Co., requests the defendants John T. Jarecki and Ernest J. Sauber, within ten (10) days after service of this request, to make the following admissions for the purpose of this action only and subject to all pertinent objections to admissibility which may be made:

1. That the following statement is true: On or about July 21, 1955, the Internal Revenue Service transmitted to plaintiff a copy of a Revenue Agent's report rejecting the plaintiff's claims for refund of excess profits taxes for 1950 and 1951 under Section 456 of the Internal Revenue Code of 1939. In this report the following was stated:

> "The word discovery, it seems could be used to describe the introduction of at least one of the drugs, namely Dramamine, considered here."

2. That the following statement is also true: On July 18, 1950, E. C. Wright, the Internal Revenue Agent in Charge at Chicago, Illinois, sent plaintiff a "30-day" letter which concluded that plaintiff was not entitled to World War II excess profits tax relief for the calendar years 1941 to 1944, inclusive, under Section 722 of the Internal Revenue Code of 1939. Enclosed with such letter was a copy of a Revenue Agent's report dated April 9, 1950, which included the following statements of fact and conclusions with respect to drugs manufactured and sold by plaintiff:

"Aminophyllin:

"Aminophyllin was presented to the American Pharmaceutical Association meetings at Baltimore, [fol. 32] Maryland, May 5-10, 1930 by P. W. Schmitt of the Searle Laboratories.

"According to the Council of Pharmacy and Chemistry of the American Medical Association—'Aminophyllin has the action and uses of theophyllin and theophyllin sodio acetate over which it has the advantage of greater solubility. Like these it has a diuretic action, produces myocardial stimulation and occasionally may be useful in relieving the pain in coronary disease.' (From the publication—New and Non-Official Remedies—1934 of the A. M. A.)

"In 1934 New and Non Official Remedies, the Council on Pharmacy and Chemistry listed the following products and manufacturers under the heading theophyllin:

Aminophyllin—Pharmedic * * * No patent or trademark.
Aminophyllin—Searle * * * No patent or trademark.
Metaphyllin —Byk Guldenwerke, Chemsche Fabrick, Berlin, Germany, Distributors Adolph Hurst and Company, N. Y., N. Y. (Discontinued in 1936 by the A. M. A. Council).

"1934 was the first year that Searle's Aminophyllin was accepted by the American Medical Association's Council on Pharmacy and Chemistry. In 1936 Dubins Aminophyllin was accepted by the American Medical Association. More and more companies entered the Aminophyllin field from 1936 on. A study of the number of companies selling Aminophyllin up to 1941 is shown by Exhibit C. From 5 companies listed as suppliers in 1935 the list grew to 13 in 1939 and 24 in 1941. This list does not attempt to review all products with a theophyllin base which would have a similar therapeutic use.

"Sales pamphlets of the G. D. Searle Company relating to aminophyllin were available as early as 1930 titled 'Aminophyllin in the treatment of Cardiac Disease.' In 1932 the trade received sales lit-
[fol. 33] erature from G. D. Searle and Co. called 'A Modern Conception of Rational Drug Treatment in Cardiac Conditions Associated with Pain.' The tax-

payer's claim, page 7 erroneously indicates the basic chemical was developed in 1933.

"In 1933 the company offered three forms of aminophyllin, i. e., two sizes of ampuls and one size of tablets. In 1935 aminophyllin in powder form was added. In 1936 two sizes of tablets of aminophyllin with phenobarbital and one size tablet of aminophyllin with phenobarbital and one size tablet of aminophyllin with potassium iodide were added to the four forms of aminophyllin previously offered. The 1939 catalogue lists another size of aminophyllin ampul. By 1941 nine dosages of aminophyllin, two dosages of aminophyllin with phenobarbital and one form of aminophyllin with potassium iodide, or a total of twelve aminophyllin items were offered for sale.

"The sales of aminophyllin, all forms, was presented by the claim in dollar amount only. The product in relation to total dollar sales of the taxpayer from 1934, the year of American Medical Association approval, is as follows:

G. D. Searle & Co.

Aminophyllin

Year	Amount	Per cent of total Company sales
1934	$137,361	19.8
1935	208,120	22.3
1936	256,887	23.0
1937	264,435	18.7
1938	327,934	21.0
1939	906,446	23.6

"Considering all the above facts carefully it appears that aminophyllin was introduced by G. D. Searle in 1930. By 1935 the product had reached normal in relation to the company's base period sales.

[fol. 34] "Conclusion:

"Aminophyllin does not qualify as a new product because it was not introduced immediately prior to the base period.

"Metamucil:

"This product, introduced in May 1934, was described in the taxpayer's catalogue of 1935 as 'the purified and concentrated vegetable mucilloid prepared from the seed of Plantago Ovata (Forsk), held in dispersion with a specially prepared milk powder.'

"This product is essentially in the laxative group of remedies. However, due to its special application, Exhibit D lists only colloidal and fiber group remedies designed primarily to supply or enhance the residue of the fecal mass and yet not bring about undue irritation to the colon. Including Psyllium seed in both 1935 and 1939 the number of similar products apparently about doubled in the four year period.

"The sales of the product by year is scheduled as follows for G. D. Searle & Co.

Year	Amount	Per cent of total Company sales
1934	$ 65,981	9.5 (7 months)
1935	181,495	19.5
1936	223,758	20.0
1937	332,073	23.5
1938	359,134	22.9
1939	370,207	21.5

"It seems that Metamucil attained maturity in relation to company sales much quicker than aminophyllin. This is inherent in the nature of the two products. Remedies for cardiac condition would advance as knowledge of their therapeutic effect broadened and evidences of unpleasant or dangerous propensities were discounted. However psyllium seed was well known to be a harmless laxative. Certainly a refine-

ment of this natural laxative could be adaptable to faster sales development than cardiac remedies.

[fol. 35] "However, the product was not introduced immediately prior to the base period so can not be a qualifying factor. The Tax Court, in Monarch Cap Screw and Manufacturing Company, *supra*, said 'Even if the increase in the type or quantity of articles manufactured may be considered a change in the character of the business as defined in the statute such change took place in 1934 and not during or immediately prior to the base period.' Also *Acme Breweries* v. *Comm*, *supra*.

"Floraquin:

"In June 1936 Floraquin appeared in the sales picture of the taxpayer. Initial literature was aimed at the treatment of leukorrhea. The 1936 catalogue also stated the product was adaptable to specific treatment of trichmona vaginalis. Later sales pamphlets were aimed at this specific disease.

"The essential ingredient of Floraquin is Diodoquin. Floraquin is 1½ gr. of diodoquin, lactose and specially prepared anhydrous dextrose adjusted by acidulation with boric acid to the proper hydrogen concentration for re-establishing the normal acidity and bacterial flora.

"Diodoquin (5-7 diodo-8-hydroxyquinoline) was also first listed in 1936 by the G. D. Searle & Co. catalogue. Diodoquin and Floraquin are chemically related to Chiniofon which in 1936 was sodium iodohydroxyquinolinesulfonate. Diodoquin and Chiniofon are protozoacides for the intestinal tract. Chiniofon was introduced substantially before the base period, probably about 1930.

"The taxpayer had other products which had a similar therapeutic effect as Floraquin. A product called Suppositones was for the palliative treatment of similar female diseases. Though no other similar remedy of the taxpayer used the hydroxyquinoline base it was a reasonable development of the protozoacide Chiniofon and merely extended the line of the taxpayer's products for female diseases.

[fol. 36] Floraquin

Year	Amount	Per cent of total Company sales
1936	$ 41,123	3.7 (7 months)
1937	96,469	6.8
1938	97,818	6.3
1939	120,972	7.0
1940	164,925	8.7
1941	158,161	6.8

"Remedies for trichomonas vaginalis vaginitis as listed in the 1941 edition of the Modern Drug Encyclopedia and Therapeutic Guide are compared in Exhibit E. The increase of remedies particularly adaptable to trichamonas vaginalis increased from 11 in 1935 to 16 in 1939 and 18 in 1941. This list is not intended to be all inclusive but is furnished to show that an increasing number of products were aimed at this type of disease by the pharmaceutical industry.

"Ketochol:

"Ketochol is described by the taxpayer's catalogue as a combination of the oxidized or keto form of bile acids (cholic desoxycholic, chenodesoxycholic and lithocholic acids) normally present in human bile. Ketochol was considered by the trade to be composed largely of dehydrocholic acid.

"The Modern Drug Index and Therapeutic Guide 1941 Edition lists Ketochol as a choloretic and distinguishes between choloretics and cholagogues. However, the 1934 Edition made no such distinction therefore the 1941 Edition was used to obtain a list of products of similar therapeutic use as shown by Exhibit F. However, a 1945 Edition of Gould's Medical Dictionary defines both cholagogue and choloretic as tending to increase the flow of bile. In the 1930's bile remedies were often used for their laxative effect too. Among the Searle products which affected the bile and or gall bladder are the following with a brief description of their suggested usage from the taxpayer's catalogue of 1935.

[fol. 37] "Cas-ca-bile—(Searle)—for use as a Cholagogue, digestive stimulant and a mild cathartic. Also retained in 1939 catalogue.

"Cholphenolate—(Searle)—* * * is indicated in any condition associated with deficient secretion of bile and is particularly effective in the treatment of chronic constipation. Also listed in the 1939 catalogue.

"Magnesium Sulfate Enteric Coated—Used in condition where non-surgical drainage of the gall bladder is indicated and as a laxative. Retained by 1939 catalogue.

"Oxgall Salol Compound—Suggested in the treatment of intestinal indigestion, catarrhal condition of the intestines and deficient biliary secretion. Listed in 19 ' catalogue.

"Chronanthus Compound: Hepatic stimulant and cathartic for inactivity of the liver. Dropped from 1938 catalogue listing.

"Ketochol, first listed in the 1938 catalogue—'A definite choloretic action in stimulating the liver cells to secrete an increased quantity of bile, producing increased activity of the entire biliary apparatus including the gall bladder, facilitates drainage and overcomes bile stasis." This product was brought out in February 1937.

"In August 1939 the Journal of the American Medical Association announced that Ketochol was determined to be non-acceptable as a New and Non Official Remedy by the council on Pharmacy and Chemistry.

"The dollar sales volume of Ketochol and its relation to total sales of the company are as follows:

Year	Amount	Per cent of total Company sales
1937	$116,322	8.2 (11 months)
1938	229,157	14.7
1939	293,388	17.0
1940	286,536	15.2
1941	298,131	12.8
1942	300,958	11.7

[fol. 38] "This schedule shows 1939 to be the year of maximum development in relation to total company sales.

"It is apparent from the number of biliary remedies that Ketochol is an extension of the company's line of products for treatment of liver and gall bladder diseases.

"Exhibit F shows the increasing number of products of a similar therapeutic use increasing from 8 in 1935 to 18 in 1939, to 26 competing products in 1941.

"The Bulletin on Section 722 (G.P.O. Issue, Page 50) under a difference in products or services furnished states: 'Such addition or elimination (of products) however, must represent more than a usual or customary event in the type of business in which the taxpayer is engaged.' * * * Moreover, a product or service must be substantially different from the products or services previously furnished; mere improvement does not constitute a difference. The addition or elimination of a new product to or from a line of varied products, as where a novelty store selling hundreds of items adds several new lines, will not ordinarily be held to constitute a difference in products furnished.'

"Ketochol was another item added to some 350 Pharmaceutical items in the line in 1937. Ketochol was another biliary or liver remedy supplementing existing catalogue items of the claimant. Therefore, Ketochol fails to qualify as a new product.

"Other Research Products:

"The other 'research' products, and their year of introduction, included in the taxpayer's chart on page 6 of the claim, *supra*, are Iodochlorol—1934, Sylnasol—1935, Diodoquin—1936, and Furmerane—1941. Dollar sales volume by year to agree with the claim are as follows:

[fol. 39]

Year	* Iodo-chlorol	** Sylnasol	Diodoquin	Fumerane	Total per claim	Total Corrected for Notes Below
1934	$	$	$	$	$	$
1935	5,958				5,958	12,261
1936	10,432	15,928	E 4,000		30,360	34,360
1937	12,355	17,543	E 8,000		32,898	45,898
1938	13,551	18,762	E 12,000		44,223	48,223
1939	14,694	18,603	20,521		53,711	53,711
1940	17,278	17,643	20,539		55,460	55,460
1941	33,159	23,479	23,879	10,762	91,279	80,517***

* Listed in 1934 catalogue.

** Formerly "Sylasol". Sales totaled $6,303.00 for last quarter of 1935.

*** Eliminating 1941 product.

E Corrected estimate based on Floraquin should be approximately 1936—$8,000, 1937—$16,000, 1938—$16,000. These figures are used in column 7.

"The percentage of sales of other Research Products to total sales of the company are as follows:

Year	Corrected Amount as Above	% of Total Company Sales
1935	$ 12,261	1.32
1936	34,360	3.07
1937	45,898	3.25
1938	48,223	3.08
1939	53,711	3.11
1940	55,460	2.94
1941	80,577	3.44

"These products obtained substantial maturity in 1936 in relation to total sales so that further consideration as qualifying factors is not deemed necessary in this report.

"To summarize conclusions relative to research products or new products:

"Aminophyllin does not qualify as new product or a research product of the new management as it was

developed prior to 1933 and was not a change immediately prior to the base period.

"Metamucil and Iodochlorol were developed after 1933 but do not qualify as a new product introduced immediately prior to the base period.

[fol. 40] "Floraquin and Diodoquin were of a similar chemical background. Both products were of a class similar to those previously marked by the company.

"Ketochol was a therapeutic remedy of a class already marketed by the company.

"The taxpayer fails to show a change in the character of the business, either through management, marketing or research policies, which were made during or immediately prior to the base period and which resulted in an inadequate standard of normal earnings for the entire base period."

Sidley, Austin, Burgess & Smith,
Attorneys for plaintiff.

Proof of Service (omitted in printing)

IN THE UNITED STATES DISTRICT COURT

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PLAINTIFF'S ANSWER TO REQUEST FOR ADMISSIONS—Filed March 30, 1959

Plaintiff, G. D. Searle & Co., through its Treasurer, Kenyon D. Bowes, being first duly sworn, states in reply to the request by defendants for admissions, dated March 19, 1959:

1. Admits the accuracy of the documents described in the first five paragraphs of the defendant's request for admissions, but states that Exhibit C attached to the defendants' request was submitted by the plaintiff to the Internal Revenue Service during 1950.

[fol. 41] 2. Admits the truth of the statements of fact contained in paragraph 6(a) and (b) of the request, but states that the quoted portion of Article Four was only part of the revisions of plaintiff's Articles of Incorporation made at the time of its first public stock offering. The quoted excerpt from Article Four was merely one of several revisions made in 1950 to modernize Searle's Articles of Incorporation and did not reflect any change in its business. Moreover, plaintiff's Board of Directors voted to amend the Articles of Incorporation on January 5, 1950, rather than on January 16, 1950.

3. Admits the truth of the statement of fact contained in paragraph 6(c), (d) and (e) of the request.

G. D. Searle & Co.,
Plaintiff,

By Kenyon D. Bowes,
Treasurer.

• • • •

Proof of Service (omitted in printing)

[fol. 42] IN THE
UNITED STATES DISTRICT COURT

• • • • •

OBJECTIONS OF THE DEFENDANTS TO THE PLAINTIFF'S REQUESTS FOR ADMISSIONS—Filed March 31, 1959

Now come the defendants in the above case and request the Court to grant an Order relieving them from replying to the plaintiff's Requests for Admissions served upon them on March 23, 1959, as the matters therein referred to could neither constitute evidence nor lead to evidence in this proceeding. Furthermore, and more explicitly, both Requests 1 and 2 refer to alleged statements by employees or former employees of the Internal Revenue Service concerning matters peculiarly within the personal knowledge of the plaintiff and not within the personal knowledge of those employees. Therefore, such statements are, even if interpreted as admissions, admissions of opinions, not of facts, and as such they are totally irrelevant.

R. Tieken,
United States Attorney.

IN UNITED STATES DISTRICT COURT

• • • • •

MOTION OF DEFENDANTS FOR SUMMARY JUDGMENT—Filed March 31, 1959

Now come the defendants, John T. Jarecki and Ernest J. Sauber, by and through R. Tieken, United States Attorney in and for the Northern District of Illinois, and move the Court for an Order granting this Motion and dismissing the instant action with prejudice and with costs assessed against the plaintiff.

This motion is predicated upon the pleadings, stipula-
[fol. 43] tion of facts and the plaintiff's responses to the defendants' Requests for Admissions of Fact and the genuineness of documents, all of which are part of the record in this case and upon the proposition of law that

the word "discovery" used in Section 456(a)(2)(B), Internal Revenue Code of 1937, as amended, does not include products prepared through "research and development", but only refers to products which are already in existence and thus susceptible to being discovered such as certain natural resources.

R. Tieken,
United States Attorney.

IN THE UNITED STATES DISTRICT COURT

• • • •

FINDINGS OF FACT AND CONCLUSIONS OF LAW—MAY 11, 1959

The above case came on to be heard on motion of the defendants for an order granting summary judgment in their favor.

The plaintiff was represented by Walter J. Cummings, Jr., of Sidley, Austin, Burgess and Smith, and the defendants were represented by William F. Kolbe, Attorney, Department of Justice, Harvey M. Silets, Assistant United States Attorney, and R. Tieken, United States Attorney.

The court after carefully considering the pleadings, the Stipulation of Facts, certain Requests for Admission served on the plaintiff by the defendants, and the answers thereto, certain requests for admissions served on the defendants by the plaintiff and the answers thereto, the briefs of the parties and the arguments of counsel, finds the following facts to be true and uncontroverted and based thereon reaches the following conclusions of law.

[fol. 44] FINDINGS OF FACT

1. The plaintiff is a Delaware corporation with its principal place of business in Skokie, Illinois. It brings this action to recover excess profits taxes in the total amount of $3,638,238.82, plus interest thereon, which amount it alleges was erroneously and illegally assessed

and collected by the defendants for the calendar years 1950, 1951 and 1952.

2. The plaintiff is in the business of manufacturing and marketing ethical drugs and derives income therefrom.

3. Prior to 1950, and over a period of more than twelve months, the plaintiff incurred expenditures which resulted in the preparation and manufacture of two pharmaceuticals whose trade names are, respectively, Banthine and Drainamine.

4. During the years here involved, 1950, 1951 and 1952, plaintiff derived income from sales of Banthine and Dramamine. It is this income which the plaintiff claims constituted abnormal income within the meaning of Section 456(a)(2). Internal Revenue Code of 1939. This claim, which is controverted by the defendants, is the sole basis of the complaint in this case.

5. Both the drugs Banthine and Dramamine were developed from and arose out of research activities conducted by the plaintiff prior to 1950.

6. The chemical drug compounds, Banthine and Dramamine, were not in existence prior to their being prepared by the plaintiff through experiments with various chemical formulas.

7. Plaintiff applied for and received product patents on the following drugs that it marketed during the 1940-1953 period:

Product	Filed	Granted
Pavatrine	4-20-40	11-18-41
Dramamine	3-18-40	2-28-50
Banthine	5-10-52	11-17-53

[fol. 45] Its application for such patents were denied on the following:

Product	Filed	Abandoned
Hydryllin	4-29-47	7-10-52
Tetrathione	8- 7-42	4-30-48

8. Two contentions are made by the plaintiff in support of its assertion that income attributable to its sales of Banthine and Dramamine is "abnormal income" within the meaning of Section 456(a)(2), Internal Revenue Code of 1939; first, it asserts that both of these drugs were "discoveries" within the meaning of Section 456(a)(2)(B) and then alternatively, it asserts that even if this is not so, such income is subject to classification as "abnormal income" under the last sentence of Section 456(a)(2) and the Treasury Regulations promulgated thereunder.

9. The defendants in moving this Court for a summary judgment in their favor contend that the word "discovery" as used in Section 456(a)(2) does not include a product created or developed through research and that as the drugs Banthine and Dramamine are products arising out of the plaintiff's research they are not discoveries within the meaning of Sections 456(a)(2)(B) and consequently income arising from their sale does not qualify for the special tax treatment set out in Section 456(a)(2).

10. This action was brought pursuant to 28 U.S.C. 1340 and the Court has jurisdiction thereof.

[fol. 46] Conclusions of Law

1. Any finding of fact which may be considered a conclusion of law is hereby concluded as a matter of law.

2. In enacting Section 456(a)(2)(B), Internal Revenue Code of 1939, Congress set out the type of income therein defined as abnormal. It stated as follows:

> (B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than twelve months; or

The plaintiff asserts that its income from the sales of Banthine and Dramamine is income resulting from a discovery. Regardless of how the word "discovery" may generally and often incorrectly, be used, it does not encompass the preparations of these drugs. They are products arising out of research and development and as such

specifically prohibited by Congress from being considered discoveries within the meaning of Section 456(a)(2)(B). See: S. Rep. 2679, 81st Cong., 2d Sess. (1951-1 Cum. Bull. 240, 249.

3. The Treasury Regulations promulgated pursuant to the last sentence of Section 456(a)(2), Internal Revenue Code of 1939 do not support the plaintiff's position. Rather they support the defendant's position. Treasury Regulations 130, Section 40-456-2(b) (as amended by T. D. 6026, 1953-2 Cum. Bull. 235) provide as follows:

> "(B) Other income, not within a class described in subparagraphs (A)-(D) of section 456(a)(2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456(a)(2) as are reasonable in a business of the type which the taxpayer conducts, [fol. 47] and as are appropriate in the light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable, for example, the class described in section 456(a)(2)(D)."

Clearly, by this regulation, income from the sale of tangible property arising out of research and development may not be classified as abnormal.

The last sentence of this regulation is not applicable to the present case.

The income which the plaintiff received from its sales of Banthine and Dramamine during 1950, 1951 and 1952 may not be classified as "abnormal income" under Section 456(a)(2) and consequently the plaintiff is not entitled to any relief in this action.

Therefore, the defendants' motion for summary judgment shall be granted and a judgment order entered accordingly.

Enter:

M. L. Igoe,
United States District Judge.

Date: May 11, 1959.

[fol. 48] IN THE
UNITED STATES DISTRICT COURT

* * * * *

JUDGMENT ORDER—May 11, 1959

In accordance with the Findings of Fact and Conclusions of Law entered in the above case,

It is Ordered that the complaint herein filed is dismissed, with prejudice, costs to abide the issue.

Enter:

M. L. Igoe,
United States District Judge.

Date: May 11, 1959.

[fol. 49] IN THE
UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS,
EASTERN DIVISION

No. 57 C 1717

G. D. SEARLE & Co., a Corporation, PLAINTIFF

vs.

JOHN T. JARECKI, former Collector of Internal Revenue, and ERNEST J. SAUBER, former Collector of Internal Revenue and former District Director of Internal Revenue, DEFENDANTS

NOTICE OF APPEAL—Filed July 10, 1959

Notice is hereby given that G. D. Searle & Co., plaintiff, hereby appeals to the United States Court of Appeals for the Seventh Circuit from the summary judgment entered for defendants on May 11, 1959.

Edwin C. Austin,
Middleton Miller,
Walter J. Cummings, Jr.,
11 South La Salle Street,
Chicago 3, Illinois.

Sidley, Austin, Burgess & Smith,
Of Counsel.

[fol. 50] United States of America,)
Northern District of Illinois,) ss.

(Caption—57-C-1717)

CERTIFICATE OF MAILING
Omitted in Printing

[fol. 51] IN UNITED STATES DISTRICT COURT

* * * * *

STIPULATION RE RECORD—July 31, 1959

It is hereby stipulated by and between the parties pursuant to Rule 75 (o) of the Federal Rules of Civil Procedure, and Rule 12 (e) of the Rule of the United States Court of Appeals for the Seventh Circuit that the record on appeal herein shall consist of the following items:

(1) Complaint filed October 16, 1957.
(2) Answer filed December 16, 1957.
(3) Defendants' first interrogatories to plaintiff filed May 29, 1958.
(4) Defendants' second interrogatories to plaintiff filed June 11, 1958.
(5) Plaintiff's answers to defendants' first interrogatories, filed June 13, 1958.
(6) Plaintiff's answers to defendants' second interrogatories, filed July 11, 1958.
(7) Stipulation of Facts filed February 16, 1959.
(8) Order of February 19, 1959, allowing plaintiff's motion for separate trial of the issues.
(9) Defendants' request for admissions under Rule 36 filed March 19, 1959, with Appendices thereto.
(10) Plaintiff's request for admissions under Rule 36, filed March 23, 1959.
(11) Plaintiff's answer to request for admissions, filed on March 30, 1959.
(12) Objections of the defendants to the plaintiff's requests for admissions, filed March 31, 1959.
(13) Defendants' motion for summary judgment, filed March 31, 1959.
(14) Transcript of oral argument before Judge Igoe on March 31, 1959.
[fol. 52] (15) Defendants' answer to plaintiff's request for admissions, filed April 2, 1959.
(16) Transcript of oral argument before Judge Igoe on April 28, 1959.
(17) Findings of Fact and Conclusions of Law with Judgment Order dismissing Complaint entered on May 11, 1959.

(18) Plaintiff's Notice of Appeal filed on July 10, 1959.
(19) This Stipulation.

Walter J. Cummings, Jr.,
Attorney for Plaintiff-Appellant,

R. Tieken,
Attorney for Defendants-Appellees.

Dated: July 31, 1959.

CLERK'S CERTIFICATE TO FOREGOING TRANSCRIPT.
Omitted in Printing

[fol. 53] • • • •

[fol. 54] IN THE
UNITED STATES DISTRICT COURT

• • • •

DEFENDANTS' ANSWERS TO PLAINTIFF'S REQUESTS FOR ADMISSIONS—Filed April 2, 1959

The defendants, having filed objections to the plaintiff's requests for admissions and these objections having been overruled, now answer said requests as follows:

1. Admit request Number 1.
2. Admit request Number 2.

R. Tieken,
United States Attorney.

[fol. 55] IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1959—JANUARY SESSION, 1960

No. 12747

G. D. SEARLE & Co., PLAINTIFF-APPELLANT

v.

JOHN T. JARECKI, former Collector of Internal Revenue, and ERNEST J. SAUBER, former Collector of Internal Revenue and former District Director of Internal Revenue, DEFENDANTS-APPELLEES

Appeal from the United States District Court for the Northern District of Ilinois, Eastern Division

OPINION—January 27, 1960

Before MAJOR, SCHNACKENBERG and CASTLE, *Circuit Judges.*

CASTLE, *Circuit Judge.* G. D. Searle & Co., plaintiff-appellant, referred to as taxpayer, instituted this action to recover excess profits taxes in the total amount of $3,638,238.82, plus interest, which amount it alleges was erroneously and ilegally assessed and collected by the Government for the calendar years 1950, 1951, and 1952. The District Court dismissed the suit on motion for summary judgment filed by the Government. The taxpayer appealed contending the granting of summary judgment was error in that it was based on an erroneous interpretation of the pertinent Internal Revenue Code provision and that a genuine issue of material fact existed.

[fol. 56] The pleadings, a stipulation of facts, and answers to interrogatories and requests for admissions disclose that the taxpayer is engaged in the manufacture and marketing of ethical drugs. Prior to 1950, and over a period of more than twelve months, the taxpayer incurred expenditures which resulted in the preparation and manufacture of two pharmaceuticals with the trade names of Banthine and Dramamine. During the years here involved the taxpayer derived income from sales of these drugs. Both were developed from and arose out of research activities conducted by the taxpayer before 1950. These chemical drug compounds were not in existence prior to their being prepared through experiments with various chemical formulas. The taxpayer applied for and received patents on both products.

The taxpayer claimed that the income from the sales of Banthine and Dramamine constituted abnormal income within the meaning of Sec. 456 (a) (2) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 456).[1]

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[1] Insofar as pertinent Sec. 456 provides:

§456. Abnormalities in income in taxable period—

(a) Definitions.

For the purposes of this section—

(1) Abnormal income.

The term "abnormal income" means income of any class described in paragraph (2) includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

(2) Separate classes of income.

Each of the following subparagraphs shall be held to describe a separate class of income:

(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; or

(C) Income from the sale of patents, formulae, or processes,

[fol. 57] Section 456 is designed to afford relief from the impact of excess profits taxes in certain situations which give rise to abnormally high income during the taxable year.

The taxpayer asserted that the income from the drugs Banthine and Dramamine qualified as income resulting from "discovery" within the class of income described in Sec. 456 (a) (2) (B) as:

> "Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months;"

And, alternatively, the taxpayer asserted that such income is subject to classification as abnormal income pursuant to the Treasury Regulations [2] promulgated under the provision of Sec. 456 that:

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or any combination of the foregoing, developed over a period of more than 12 months; or

(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary.

[2] Treasury Regulations 130, Sec. 40.456-2 (b), as amended by T.D. 6026 (1953-2) Cum. Bull. 235:

(b) Other income, not within a class described in subparagraphs (A)-(D) of section 456 (a) (2), to which section 456 is applicable, may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456 (a) (2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable, for example, the class described in section 456 (a) (2) (D).

"The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary".

The District Court held that the meaning of the word "discovery" as used in the statute, did not encompass the preparation of Banthine and Dramamine because they are products arising out of research and development, and that the Treasury Regulation, to which reference has been made, is not applicable.

The common accepted meaning of the word "discovery" includes "Finding out or ascertaining something previously [fol. 58] unknown or unrecognized; as Curie's *discovery* of radium" (Webster's New International Dictionary (Unabridged 2d ed.) p. 745). We do not deem the maximum *noscitur a sociis* applicable. The wording of subparagraph (B) of the statute indicates that each word should be given significance independently of the others. It refers to "exploration, discovery, or prospecting, or any combination of the foregoing". The context in which the word appears suggests no reason to limit or qualify its commonly accepted meaning. That the statute herein involved omitted a provision of a similar World War II Excess Profits Tax Act which in defining abnormal income included that resulting from "research, or development of tangible property" does not in our opinion serve to narrow the scope of the word "discovery" as employed in the Internal Revenue Code provision here under consideration. The elimination of "research" and "development" as factors qualifying income for abnormal income classification served the Congressional objective of plugging "a potention loop-hole of major dimensions".[3] And, absent the element of discovery, income resulting from research or development does not by reason of the latter factors qualify for treatment as abnormal income. But the plugging of the loophole which existed under a former Act because of the use of the unqualified terms "research" and "development" does not require that the word "discovery" which the Congress saw fit to re-employ in the latter enact-

[3] H. Rep. No. 3142, 81st Cong., 2d Sess., p. 13 (1951-1 Cum. Bull. 187, 189).

ment be regarded as having taken on the limited and qualified meaning the Government would ascribe to it. Neither the context of Sec. 456 nor the legislative history demonstrates that the term "discovery" was intended to describe only the discovery of that which is already in existence *i.e.* natural resources. If Congress had intended to limit the meaning of "discovery" it would have been a simple matter for it to have expressly done so.

It is our opinion that income resulting from discovery is not under the terms of subparagraph (B) of the statute precluded from classification as abnormal income merely because research or development may have occasioned, or have been factors which contributed to, the discovery. It [fol. 59] is unnecessary to consider the argument advanced by the taxpayer concerning the application of the Treasury Regulation.

We conclude that the District Court erred in its interpretation of the statute and in granting summary judgment for the Government. A genuine issue of material fact existed as to whether Banthine and Dramamine were actually discoveries. Nothing we have said should be regarded as indicating any expression of opinion on the factual issue.

The judgment of the District Court is reversed and the cause remanded for further proceedings not inconsistent with this opinion.

REVERSED AND REMANDED.

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[fol. 60] IN UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

• • • •

No. 12747

G. D. SEARLE & CO, PLAINTIFF-APPELLANT

v.

JOHN T. JARECKI, former Collector of Internal Revenue, and ERNEST J. SAUBER, former Collector of Internal Revenue etc., DEFENDANTS-APPELLEES

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

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JUDGMENT—January 27, 1960

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, and that this cause be, and it is hereby REMANDED to the said District Court for further proceedings not inconsistent with the opinion of this Court filed this day.

[fol. 61] IN UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

(Title Omitted)

ORDER DENYING MOTION FOR LEAVE TO FILE PETITION FOR REHEARING—April 28, 1960

This matter comes before the Court on the motion of defendants-appellees for leave to file a petition for rehearing out of time and documents tendered therewith, and the memorandum of plaintiff-appellant in opposition to said motion.

On consideration whereof, IT IS HEREBY ORDERED that the said motion for leave to file petition for rehearing out of time be, and the same is hereby, DENIED.

[fol. 62] UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

* * * *

Clerk's Certificate to foregoing transcript omitted in printing

[fol. 63] SUPREME COURT OF THE UNITED STATES

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ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—April 22, 1960

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including June 25th, 1960.

/s/ Tom Clark
Associate Justice of the Supreme Court of the United States

Dated this 22 day of April, 1960.

[fol. 64] SUPREME COURT OF THE UNITED STATES

No. 151, October Term, 1960

JOHN T. JARECKI, Former Collector of Internal Revenue, et al., PETITIONERS

vs.

G. D. SEARLE & Co.

ORDER ALLOWING CERTIORARI. October 10, 1960.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1960 574975 595